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Switzerland

Introduction
Switzerland does not have specific transfer pricing regulations but respectively adheres to the Organisation for Economic Co-operation and Development (OECD) Guidelines. As far as is predictable, Switzerland has also no plans to issue any domestic provisions on transfer pricing in the near future. Swiss tax authorities, however, are becoming increasingly concerned that taxpayers may transfer profits without economic justification to countries with strict transfer pricing rules and documentation requirements in order to avoid challenges by the respective local tax authorities. In this context, Swiss tax authorities take an increasing interest in a company’s transfer pricing position in order to defend their own position. In addition, some cantonal tax authorities have begun to particularly focus on low-risk/low-profit entities located in Switzerland. Further, the tax authorities have begun to also focus tax audits on principal companies in Switzerland, which would include transfer pricing. To clarify transfer pricing issues, Switzerland offers an informal procedure for agreeing pricing policies in advance.

Statutory rules
Whilst Swiss tax law neither contains an explicit definition of the arm’s length principle, nor specifically addresses the issue of transfer pricing between related parties, there is some legal authority for adjusting the profits of a taxpayer on an arm’s length basis. This legal authority is found in Article 58 of the Federal Direct Tax Act as well as in Article 24 of the Harmonisation of the Cantonal Tax Laws Act, which both define the calculation of a taxpayer’s taxable net profit. Importantly, Articles 58 and 24 deny a tax deduction for expenditure that is not commercially justifiable, and this provides the basis for an adjustment to profits for non-arm’s length terms.

Other regulations
Services
Other regulations deal with the requirement for Swiss subsidiaries and permanent establishments (PEs) of foreign companies to include a profit markup when recharging the cost of performing services to a foreign-related company. No markup is required, however, where there is evidence that the marked up price would be substantially different from the price that would have been paid in a comparable uncontrolled situation. In addition, an instruction issued in Circular Letter No. 4 on 19 March 2004 provides guidance on the treatment of certain services that do not require a cost plus methodology (e.g. certain financial services and general management services) and encourages a review of the methods and margins (or prices) charged for rendering such services when evaluating whether such charges were made on an arm’s length basis. Nevertheless, in most cases, the past practice of charging cost plus 5%–10% should meet the third-party comparison test and remain acceptable to the tax authorities under the new regulations.
Note that, since the cantonal authorities are not bound by the instructions of the Federal Tax Administration when assessing taxes, there is some room for differences in approach between cantons. Therefore, it is possible that the cantonal authorities may adopt different methods of calculating the base of costs to be marked up.

**Interest payments**

Switzerland maintains regulations concerning permitted tax-deductible interest rates on loans. The Federal Tax Administration regularly issues instructions on the safe harbour maximum and minimum interest rates as set by reference to the prevailing interest rates in the Swiss market. If a loan is in a foreign currency, the relevant market interest rates apply, which is, effectively, an application of the arm’s length principle. In practice, there is an interdependence of permissible interest rates and the permissible amount of debt in the context of thin capitalisation. If companies deviate from the safe harbour rates, it is strongly advised that they maintain documentation to support the arm’s length nature of the rates applied, as there have been an increasing number of audits in this area.

**Legal cases**

Several cases on transfer pricing have been brought before the Swiss courts, especially concerning the interpretation of ‘costs which are not commercially justifiable’ (e.g. non-arm’s length transactions of management services, licence fees or excessive interest rates on loans made by a shareholder to a company), the use of company assets by the shareholder on privileged terms, and the restructuring of sister companies by means of non-arm’s length transactions.

**Burden of proof**

The burden of proof within Switzerland lies with:

- the taxpayer regarding the justification of tax-deductible expenses, and
- the tax authorities regarding adjustments which increase taxable income.

This effectively means that a taxpayer has to prove to the Swiss tax authorities that the price it has paid for its tangibles, intangibles and any services it has received from a related party satisfies the arm’s length principle (i.e. justifies their tax deductibility). On the other side, the Swiss tax authorities’ responsibility is to prove that the compensation for any services rendered by the taxpayer or any tangibles or intangibles transferred to a related party does not reach an arm’s length level. However, if a taxpayer fails to produce the documents required by the tax authorities, this burden of proof also reverts to the taxpayer. Therefore, Swiss taxpayers should maintain appropriate documentation to justify all income and expenses resulting from related party transactions.

**Tax audit procedures**

In general, the attitude of the Swiss tax authorities towards transfer pricing in the course of tax audits has become more aggressive, especially when non-Swiss-headquartered companies are in a loss position.

**Selection of companies for audit**

Companies can be selected for investigation if relevant profit-level indicators (e.g. gross margin, net margin or return on capital) differ significantly from what is considered reasonable, or if the company is thinly capitalised.
Switzerland

_Provision of information and duty of the taxpayer to cooperate with the tax authorities_

The tax authorities may request any information that is relevant for properly assessing a company’s profits. If the taxpayer does not comply, fines may be imposed and the burden of proof moves from the tax authorities to the taxpayer.

_The audit procedure_

The normal tax audit procedures are performed by the cantonal tax authorities in respect of cantonal and federal taxes. It is normal in Switzerland for the outcome of such an investigation to be decided as a result of negotiation, but if no agreement can be reached, an adjustment is imposed. In practice, the conduct of the taxpayer during the investigation can significantly affect the size of any adjustment – cooperation is more likely to lead to a satisfactory resolution.

It has been noticed, however, that the Federal Tax Department is becoming more aggressive and is intensifying audit procedures, in particular regarding withholding tax in connection with hidden distribution of profits based on non-arm’s length transactions and with respect to Swiss value added tax (VAT).

_Revised assessments and the appeals procedure_

If the taxpayer disagrees with the assessment, he or she is entitled to make a formal appeal to the tax authorities. If the appeal is partly or entirely dismissed, then the taxpayer has the right to appeal to the Cantonal Tribunal and ultimately to the Swiss Federal Supreme Court.

_Additional tax and penalties_

Penalties apply where an adjustment is required as a result of a transfer pricing investigation in connection with a criminal proceeding (e.g. in the case of tax fraud). These penalties are not tax deductible. The level of penalties imposed depends on the extent to which the taxpayer has defaulted and can be set as a multiple of between one and three times the additional tax revenue.

No penalties apply on transfer pricing adjustments during a normal tax assessment.

Further, for Swiss withholding tax purposes, any transfer pricing adjustment and the repayments or the issuance of credit notes by the Swiss company due to adjustments made by foreign tax jurisdictions and to the extent not agreed in a mutual agreement procedure are considered as deemed dividend distributions and are therefore subject to 35% Swiss withholding tax or grossed-up to 54% if the Swiss withholding tax charge itself is not borne by the beneficiary. However such Swiss withholding tax might be partially credited or refunded based on a potential double tax treaty between Switzerland and the corresponding foreign tax jurisdiction.

_Resources available to the tax authorities_

The resources available to the Swiss tax authorities depend to a great extent on the canton involved. Zurich, for example, has its own experts, while small cantons are largely dependent on the experts within the Federal Tax Administration or the newly created State Secretariat for International Financial Matters (SIF).
**Use and availability of comparable information**

If challenged by the Swiss tax authorities, taxpayers must demonstrate that any transfer prices were based on sound economic and commercial reasoning. Documentary evidence, such as board minutes detailing the assumptions made and the expectations of the pricing policy, would normally be required. Furthermore, there is generally no publicly accessible information on which to base a local comparables study.

A pan-European benchmarking analysis generally supports the defence of transfer prices in Switzerland.

**Risk transactions or industries**

All transactions between related companies are equally likely to be challenged. No single industry sector or type of entity, with exception of low-risk/low-profit entities, appears to be more likely targeted than any other. However we are noticing a more aggressive approach with respect to structures involving offshore tax jurisdictions.

**Limitation of double taxation and competent authority proceedings**

Switzerland’s competent authority under the tax treaties is the SIF and the competent authority process is well established. Once a decision is final under Swiss law, competent authority procedures are the only means for a taxpayer to avoid double taxation.

**Advance pricing agreements**

No formal procedure for agreeing pricing policies in advance with the tax authorities exists in Switzerland. The advance pricing agreements (APAs) procedure is therefore informal in its nature. APAs are available to all industries (unilateral and bilateral).

**Anticipated developments in law and practice**

Since the Swiss Tax Authorities believe that transfer pricing issues cannot be resolved through the provisions of domestic legislation, no significant changes to the existing statutory rules are expected. Indeed, the Swiss approach to transfer pricing issues is to follow the OECD Guidelines as closely as possible.

Swiss Tax Authorities have experienced and educated tax officers regarding transfer pricing issues and the use of the options for tax adjustments granted under the existing Swiss tax legislation. This may have particular implications on costs related to the provision of services, licence fees and costs for tangible goods charged to Swiss companies, since the burden of proof in justifying the deductibility of expenses lies with the Swiss taxpayer.

We also perceive that tax authorities in certain cantons are increasingly insisting on an arm’s-length remuneration for assumed intellectual property transferred in connection with a transfer of business opportunities.

**Liaison with customs authorities**

The customs authorities assess customs duties and levy VAT on imported goods (the ordinary VAT rate is 8%). Consequently, information is regularly exchanged between the customs and VAT authorities. Since the VAT authorities themselves
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form a subdepartment of the Federal Tax Authorities, the trend towards exchange of information between the VAT and the income tax resp. withholding tax authorities is increasing.

Consequently, transfer pricing adjustments should be considered for income tax, withholding tax as well as VAT purposes. An adjustment to the returns made for customs duty purposes is generally not required, since Swiss customs duty is based on weight and not on monetary value (although there are a few exceptions).

OECD issues
Switzerland is a member of the OECD and has accepted the initial as well as all the updated OECD Guidelines on transfer pricing without reservation.

In an instruction issued 4 March 1997, the Director of the Federal Tax Administration informed the cantonal tax authorities about the contents of the OECD Guidelines on transfer pricing and asked the authorities to observe these guidelines when adjusting profits or when assessing multinational enterprises in the canton.

Joint investigations
The Swiss authorities do not join with the tax authorities of another country to participate in a joint investigation. However in case the tax treaty allows an exchange of information, Swiss tax authorities are obliged to share certain and specific information (i.e. with jurisdictions where a tax treaty is in place, which contains similar or the same regulations of article 26 of the OECD Model Tax Convention).

Thin capitalisation
As previously noted, the Federal Tax Administration frequently issues instructions in connection with minimum and maximum permissible interest rates. If interest rates charged are not within the specified range, then the rate may be adjusted. In conjunction with this practice, specific legislation indicates the permissible debt-to-equity ratios. At the federal level, an instruction was released in June 1997 according to which the debt-to-equity ratio must be determined based on the fair market value of a company’s assets. The Federal Tax Administration believes that the amount of available borrowings should be determined depending on the category of assets (receivables, participations, loans, property, installations, machinery, intangibles). Regarding finance companies, the safe harbour ratio is 6:1. The same rules apply to Cantonal Tax Law based on Article 29 (a) of the Act on Harmonisation of Cantonal Tax Laws.

Some flexibility is available in the application of these rules, particularly where they interact with the instructions on permissible interest rates. Thus, where the combination of a modest interest rate with excessive indebtedness results in an interest charge that is arm’s length, given the amount of debt that would normally be permissible, it is unlikely that any adjustment would be made to the actual interest paid. Obviously, an excessive interest rate on a high amount of debt would not be acceptable.

Management services
The charging for management services by Swiss service companies and PEs is subject to instructions from the Federal Tax Administration. Specific guidelines regulate the costs to be recharged and the method of calculating an appropriate profit element. Generally, a cost plus approach is deemed appropriate (see Other regulations section, above).